

**Office of Chief Counsel
Internal Revenue Service
memorandum**

Number: **201021020**

Release Date: 5/28/2010

CC:ITA:B04:
POSTF-147964-09

Third Party Communication: None
Date of Communication: Not Applicable

UILC: 453A.03-00

date: February 2, 2010

to: James E. Kagy
Senior Counsel (Cincinnati, Group 1)
(Large & Mid-Size Business)

from: Michael J. Montemurro
Branch Chief, Branch 4
Office of Associate Chief Counsel
(Income Tax & Accounting)

subject:

Legend

Taxpayer =
Date 1 =
Date 2 =

This Chief Counsel Advice responds to your request for assistance dated November 17, 2009. You asked us to address issues concerning the computation of interest on the deferred tax liability under § 453A of the Internal Revenue Code on Taxpayer's installment sales contract. Taxpayer used an accrual method of accounting. We have assumed that Taxpayer's installment sales contract does not have contingent payments. If, after further case development, it is established that Taxpayer's installment sales contract has contingent payments, please contact us. This advice may not be used or cited as precedent.

Issue 1

Is the computation of the § 453A interest payment amount affected by whether the installment sale occurred on the last day of Taxpayer's short taxable year?

No. In general, the purpose of § 453A is to require taxpayers using the installment method to pay an interest charge each year on the portion of the tax liability that was deferred under the installment method. Section 453A(c)(1) provides that if an obligation to which § 453A applies is outstanding as of the close of any taxable year, the tax imposed for such taxable year is increased by the amount of interest determined in the manner provided in § 453A(c)(2). Section 453A(c)(2) provides that the interest equals the product of the applicable percentage of the deferred tax liability with respect to such obligation multiplied by the underpayment rate in effect under § 6621(a)(2) for the month with or within which the taxable year ends. Section 453A(c)(3) defines “deferred tax liability” as the product of the amount of gain with respect to an obligation which has not been recognized as of the close of such taxable year, multiplied by the maximum rate of tax in effect under §1 or §11, whichever is appropriate, for such taxable year. Thus, the required interest charge arises as of the last day of the taxable year regardless of whether a sale occurs on the last day of the taxable year or any other day in the taxable year. Thus, Taxpayer is subject to the § 453A(c) interest charge for its taxable year ending Date 1 for the installment sale that occurred on Date 1.

Issue 2

Should Taxpayer compute § 453A(c) interest by applying a weighted average of the interest rates determined under § 6621(a) in effect on Date 1 and Date 2?

No. Under § 453A(c)(2), the payment computation is based on the § 6621(a) rate as of the close of the taxable year. Thus, Taxpayer uses the § 6621(a) interest rate in effect on Date 1, the last day of its taxable year.

Issue 3

Section 453A(c)(5) provides that the amount payable under § 453A(c) is used in computing a taxpayer’s deduction for interest paid or accrued during the tax year. Does the term “tax year” refer to the year that the required addition to tax under § 453A is imposed, or to the subsequent year during which the interest is paid?

Section 1.461-1(a)(2)(i) of the Income Tax Regulations provides that under an accrual method of accounting, a liability is incurred, and generally is taken into account for tax purposes, in the taxable year in which all events have occurred that establish the fact of the liability, the amount of the liability can be determined with reasonable accuracy, and economic performance has occurred with respect to the liability.

Section 1.461-4(e) provides that in the case of interest, economic performance occurs as the interest cost economically accrues, in accordance with the principles of relevant provisions of the Code.

The all events test for the obligation, which is treated by statute as interest, is satisfied at the close of the tax year in which it is imposed. Pursuant to § 453A(c) the fact of

liability is established at the close of that year because it is imposed by statute at that time. The amount of the liability can be determined with reasonable accuracy at that time because the deferred tax liability upon which this interest is paid is calculated based on the amount of gain that has not been recognized as of the close of that year. Economic performance has occurred because the "interest" obligation economically accrues during that year as a result of the liability relating to a benefit provided during that year.

We hope this information is helpful. Please call _____ or _____ at (202) 622-4920 if you have any further questions.

This writing may contain privileged information. Any unauthorized disclosure of this writing may undermine our ability to protect the privileged information. If disclosure is determined to be necessary, please contact this office for our views.